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OFFICE OF THE AUDITOR GENERAL



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

September 21, 2007

Mr. Robert J. Kleine
State Treasurer
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine:

This is our report on our follow-up of the 16 material findings (Findings 1 through 7, 9 through 14, 16, 20, and 21) and 20 corresponding recommendations reported in the performance audit of the Bureau of Local Government Services, Department of Treasury. That audit report was issued and distributed in February 2004; however, additional copies are available on request or at <<http://www.audgen.michigan.gov>>.

Our follow-up disclosed that the Bureau and the Department had complied with 7 recommendations, had generally complied with 2 recommendations, had partially complied with 5 recommendations, and had not complied with 5 recommendations. One recommendation was no longer applicable.

If you have any questions, please call me or Scott M. Strong, C.P.A., C.I.A., Deputy Auditor General.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.
Auditor General

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BUREAU OF LOCAL GOVERNMENT SERVICES

DEPARTMENT OF TREASURY

FOLLOW-UP REPORT

INTRODUCTION

This report contains the results of our follow-up of the material findings and corresponding recommendations and the agency's preliminary response as reported in our performance audit* of the Bureau of Local Government Services, Department of Treasury (27-290-02), which was issued and distributed in February 2004. That audit report contained 16 material conditions* (Findings 1 through 7, 9 through 14, 16, 20, and 21) and 13 other reportable conditions*.

PURPOSE OF FOLLOW-UP

The purpose of this follow-up was to determine whether the Department of Treasury had taken appropriate corrective measures in response to the 16 material findings and 20 corresponding recommendations.

BACKGROUND

The Bureau of Local Government Services, Department of Treasury, provides various services to local units of government through three divisions:

1. Property Services Division

The Property Services Division provides staff support to the State Tax Commission by processing exemption certificate applications for various specific tax programs, such as industrial facilities, neighborhood enterprise zone facilities, and air and water quality facilities. Also, the Division administers the State's delinquent property tax reversion* process and administers the Special Assessment* Deferment Fund*.

* See glossary at end of report for definition.

2. Assessment and Certification Division

The Assessment and Certification Division provides staff support to the State Tax Commission, local assessors, and equalization directors by administering State property tax laws that govern the valuation and equalization of property, the certification of various tax rates, and the valuation of State assessed utility property. Also, the Division provides support to the State Assessors Board, which approves and conducts training courses and administers examinations for assessing officers.

3. Local Audit and Finance Division

The Local Audit and Finance Division reviews audits received, conducts audits, monitors the financial condition, and assists other State agencies that are conducting investigations of counties and other local units of government. The Division maintains a uniform chart of accounts and reporting requirements for local units of government. Also, the Division monitors and approves local unit deficit elimination plans; reviews applications for the issuance of debt; and monitors industrial facility tax* (IFT), State education tax* (SET), and real estate transfer tax* (RETT) collections.

SCOPE

Our fieldwork was conducted primarily during April and May 2007. We reviewed State laws to determine whether there were any changes since the prior audit. We interviewed Bureau personnel, reviewed corrective action plans, and reviewed supporting documentation to determine whether the corrective action taken to comply with the recommendations related to the material findings occurred as represented by the Bureau.

* See glossary at end of report for definition.

FOLLOW-UP RESULTS

ADMINISTRATION OF LOCAL GOVERNMENT SERVICES

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

1. Collection of the Industrial Facility Tax

RECOMMENDATION

WE AGAIN RECOMMEND THAT THE BUREAU ESTABLISH PROCEDURES TO ENSURE THAT LOCAL UNIT TREASURERS COLLECT AND REMIT TO THE DEPARTMENT THE INDUSTRIAL FACILITY TAX THAT THEY RECEIVE FROM TAXPAYERS ON BEHALF OF THE STATE.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with the recommendation and will seek legislative and information technology tools to enable it better to monitor collections at the local level and remittance of collected taxes to the State on a timely basis.

FOLLOW-UP CONCLUSION

We concluded that the Bureau had partially complied with the recommendation.

The Bureau had developed procedures to address some of the issues noted in the audit finding related to payment remittance and collection processes for IFT. The Bureau had improved subsidiary records that document payments received; tracked which local unit treasurers had active IFT certificates within their boundaries but had not remitted IFT to the State; assumed responsibility for and began auditing property tax revenue captured under tax increment financing; revised the IFT annual tax report required to be completed and submitted to the Bureau by the local unit treasurers; and implemented a review/audit process of the IFT tax reports.

However, we noted the following issues that the Bureau had not resolved:

- a. The Bureau had not collected \$14.5 million of the \$67.0 million relating to tax years 1986 through 2001 cited in the audit finding. Approximately \$9.4 million of the \$14.5 million relates to the City of Flint and is also included in the

amount outstanding for Finding 2. The following chart shows the breakdown of the original \$67.0 million outstanding, adjustments, payments, and remaining amounts outstanding by local unit:

Local Unit	Beginning Amount Owed	Adjustments by Treasury	Amounts Not Reviewed in This Follow-Up Report	Payment Received	Remaining Amount Outstanding
Battle Creek	\$ 4,324,839	\$ (4,050,015)	\$	\$	\$ 274,824
Detroit	15,205,635	(4,846,195)		4,763,286	5,596,153
Flint	18,901,272	(940,752)	119,673	8,406,142	9,434,705
Livonia	7,370,927	(778,958)		6,616,053	(24,085) *
Portage	1,495,926	(870,010)		625,917	(1)
Sterling Heights	19,163,673	(368,784)		19,535,059	(740,170) *
Amounts not reviewed in this follow-up report (30 local units)	535,235	N/A	535,235	N/A	
Total	<u>\$ 66,997,507</u>	<u>\$(11,854,715)</u>	<u>\$ 654,907</u>	<u>\$ 39,946,457</u>	<u>\$ 14,541,428</u>

* Adjustments identified through the Bureau's audit process, combined with payments remitted by the local unit, resulted in overstatement of IFT amounts owed and paid to the State. The Bureau anticipates that the State Tax Tribunal will be called upon to resolve how much, if any, of the overpayment must be refunded by the State.

N/A = Not applicable.

- b. The Bureau had not followed up with 115 (19%) of the 617 local units that had active IFT certificates within their boundaries but had not remitted any IFT revenue to the State for tax year 2005.
- c. The Bureau had not obtained the IFT annual tax report (form 170) from 298 (48%) of the 617 local units with active IFT certificates in relation to tax year 2005. However, the Bureau sent out a notice in August 2007 requesting that the 298 local units submit their IFT annual tax report.
- d. The Bureau had not developed a methodology to calculate and bill the IFT revenue owed to the State by these local units that had not remitted any IFT revenue and/or the annual tax report. Determining how much could be owed by these local units is significant because local units that do not remit their IFT annual tax report are not subject to the audit process described in our follow-up conclusion to Finding 4.

The Bureau informed us that it is pursuing what it believes to be additional corrective action through amendatory legislation that would require the applicable local unit treasurer to submit a signed statement, with each monthly remittance to

the State, attesting to the amount of IFT revenue collected during the preceding month. In addition, the amendatory legislation would add a provision to the General Property Tax Act* authorizing the Department to charge interest against local units for untimely remittance of IFT revenue. The Bureau informed us that it has drafted amendatory language; however, it has not yet been introduced to either chamber of the Legislature.

RECOMMENDATIONS AND RESPONSE AS REPORTED IN FEBRUARY 2004:

2. Collection of State Tax Revenues Held by a City

RECOMMENDATIONS

We recommend that the Department require the City of Flint to remit timely payments of all State tax revenues that the City has received from taxpayers on the State's behalf.

We also recommend that the Department confine its assistance to local units of government within its statutory authority.

AGENCY PRELIMINARY RESPONSE

The Bureau disagrees that it has the power to charge any interest against the funds of a unit of local government for the failure of the local treasurer to carry out his/her statutory responsibility to remit collected taxes to the State on a timely basis. The Bureau would note that the State has now received \$8.0 million of the originally discovered \$12.0 million of industrial facility taxes erroneously retained by the City Treasurer during the years 1986 through 1991. The Emergency Financial Manager for the City has indicated that the City will pay the remaining \$4.0 million before June 30, 2004. In addition, as a result of continued investigation, the Bureau has determined that, of the \$22.3 million in State industrial facility taxes actually collected by the City Treasurer for the years 1994 through 2000, the amount not remitted to the State (\$7.4 million) was remitted to the Flint Public Schools and the Genesee Intermediate School District. The Bureau will investigate whether the school districts received the appropriate amount of State school aid or an inflated amount as a result of this error by the City Treasurer and work with the Department of Education to correct the matter, if necessary.

* See glossary at end of report for definition.

FOLLOW-UP CONCLUSION

We concluded that the Department had partially complied with the first recommendation and that the Department had complied with the second recommendation.

Regarding the first recommendation, of the total \$22.9 million cited in the audit finding as outstanding for tax years 1986 through 2001, the Department had collected \$12.4 million, primarily related to tax years 1986 through 1991. However, the Department had not collected \$7.0 million that the City of Flint improperly remitted to the Flint School District instead of the State for tax years 1994 through 2000. The Department had initiated court proceedings against the city and school district in 2005 to collect the amount outstanding, but the case was ultimately dismissed for nonpayment of a filing fee by the State. Also, the Department had not collected \$2.4 million owed to the State by the city related to tax years 1992 and 1993. On August 21, 2007, the Department sent a letter to the City of Flint requesting the immediate payment of both the \$7.0 million improperly provided to the Flint School District and the \$2.4 million owed in relation to tax years 1992 and 1993.

The remaining \$1.1 million of the \$22.9 million consists of \$940,800 in adjustments to the initial amounts outstanding for tax years 1992 through 1993 and \$119,700 that our follow-up did not examine.

Regarding the second recommendation, our follow-up did not identify any subsequent instances in which the Bureau's assistance to local units of government exceeded its statutory authority. The instance cited in the audit finding involved an interest-free payment plan with the City of Flint for \$12.0 million of the total \$22.9 million identified as not remitted to the State for tax years 1986 through 2001.

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

3. Accounting for the Industrial Facility Tax

RECOMMENDATION

We recommend that the Department include effective controls within its accounting and administrative control system to account for the receipt of industrial facility tax revenues.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees that it will develop controls to account for the receipt of industrial facility tax revenues.

FOLLOW-UP CONCLUSION

We concluded that the Department had complied with the recommendation.

Beginning in September 2005, the Bureau began reconciling its subsidiary records with the State's accounting system on a monthly basis.

RECOMMENDATIONS AND RESPONSE AS REPORTED IN FEBRUARY 2004:

4. Audit of the Industrial Facility Tax

RECOMMENDATIONS

We recommend that the Bureau develop an effective process to audit the industrial facility tax.

We also recommend that the Bureau conduct the appropriate audits and collect the amounts outstanding.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with this finding and intends to seek necessary legislation to grant it the power to collect from local treasurers, with interest, industrial facility taxes retained or inappropriately remitted to other taxing units.

FOLLOW-UP CONCLUSION

We concluded that the Bureau had generally complied with the first recommendation and that the Bureau had partially complied with the second recommendation.

Regarding the first recommendation, the Bureau implemented a process beginning with tax year 2005 that involves an initial review of all IFT annual tax reports submitted by local units with a more in-depth audit for those showing potential deficiencies.

However, the Bureau had not obtained an assessing officer's report (AOR) for 204 (33%) of the 617 local units with active IFT certificates in relation to tax year 2005. The Bureau informed us that the AOR is the only source for the applicable taxable value. Taxable value is a key component in the calculation of the amount of IFT due from the taxpayer and, therefore, vital data for the Bureau's IFT audit process.

Section 207.567 of the *Michigan Compiled Laws* requires city and township assessors to submit an annual assessment of taxable value for each property with an active IFT certificate within the assessor's jurisdiction to the State Tax Commission. However, the statute does not provide the Department with a means to enforce the requirement. The Bureau sent out a notice in July 2007 requesting that the 204 local unit assessors submit their respective AORs.

Regarding the second recommendation, the Bureau began conducting IFT audits during the State's fiscal year 2003-04. Between May 2004 and April 2007, the Bureau had finalized audits for 60 local units with active IFT certificates, most involving multiple tax years. These audits identified total deficiencies owed to the State of \$14.0 million. However, the Bureau had not collected \$7.7 million of these deficiencies (\$7.0 million relates to the Flint School District and is also included in the amounts still outstanding for Findings 1 and 2). Also, the Bureau had not collected an additional \$3.8 million associated with the \$33.9 million cited in the audit finding relating to tax years 1995 through 2001 (the entire \$3.8 million is included in the amount outstanding for Finding 1).

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

5. Collection of SET and RETT

RECOMMENDATION

We recommend that the Department ensure that it has received the correct amount of SET and RETT revenues owed to the State.

AGENCY PRELIMINARY RESPONSE

The Bureau respectfully points out that the property tax collection system crosses multiple fiscal years at the local level, none of which coincide with the State's fiscal year, thereby causing the type of certainty presumed in the 19th century no longer to be possible in the 21st century. The Bureau therefore agrees to attempt to craft amendments to the General Property Tax Act that reflect the many changes in circumstances that have occurred in the past 100+ years, but believes that implementation of Section 35 of the General Property Tax Act is not achievable in the present day. Further, the Department agrees to develop a program to study the appropriateness of the measure of the base for RETT as interpreted at the local level and to propose legislative corrections, if necessary.

OFFICE OF THE AUDITOR GENERAL EPILOGUE

Although the General Property Tax Act was originally enacted in 1893, Section 35 has been amended several times thereafter by the Legislature, including as recently as December 2002. In addition, other tax collection systems, such as the State's individual income tax, also cross multiple fiscal years which do not coincide with the State's fiscal year.

The SET has been required by law to be collected under the provisions of the General Property Tax Act since its inception in 1994. Using 21st century technology, implementation of the concepts in Section 35 may be achievable by improving the accounting for SET and RETT, described in Finding 6, and using the updated taxable values for SET, which are already being reported to the State by local county treasurers for each tax year.

FOLLOW-UP CONCLUSION

We concluded that the Department had not complied with the recommendation but is pursuing what it believes to be corrective action.

The Department had not implemented a process to reconcile the annual SET levy with corresponding SET collections remitted to the State by each county. A settlement/reconciliation process exists between the counties and their local units, but no process exists to reconcile amounts between the State and counties. The Department indicated that implementation of a settlement process between the State and counties would require changes to the existing legislation. However, the Department had not initiated the introduction of draft amendments that would compel counties to participate in a settlement/reconciliation process with the State.

Also, the Department had not developed a process to ensure that the State portion of RETT collected by the counties on the State's behalf was properly remitted to the State.

The Bureau informed us that the Department is pursuing what it believes to be corrective action through amendatory legislation that would require the applicable local unit treasurer to submit a signed statement, with each monthly remittance to the State, attesting to the amount of SET and RETT revenues collected during the preceding month. In addition, the amendatory legislation would add a provision to the General Property Tax Act and the Real Estate Transfer Tax Act authorizing the Department to charge interest against local units for untimely remittance of SET and RETT revenues. The Bureau informed us that it has drafted amendatory language; however, it has not yet been introduced to either chamber of the Legislature.

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

6. Accounting for SET and RETT

RECOMMENDATION

WE AGAIN RECOMMEND THAT THE DEPARTMENT IMPROVE ITS ACCOUNTING FOR SET AND RETT.

AGENCY PRELIMINARY RESPONSE

The Department agrees to evaluate and improve the methods of reconciling the revenues to the State's accounting system. However, the Department does not support recording SET and RETT revenues by county in the State's accounting system.

FOLLOW-UP CONCLUSION

We concluded that the Department had complied with the recommendation.

Beginning in October 2005, the Bureau began reconciling its subsidiary records of SET and RETT remittances with the State's accounting system. The reconciliations are performed on a monthly basis.

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

7. Collection and Oversight of Property Tax Revenue From Tax Increment Financing*

RECOMMENDATION

We recommend that the Bureau improve its collection and oversight of property tax revenue from tax increment financing, including recovery of the State's portion of property taxes identified as having been retained by local unit authorities.

AGENCY PRELIMINARY RESPONSE

The Bureau would note that, beginning in March 2003, the Bureau has resumed review of tax increment financing reports for the purpose of determining which of these amounts can be collected and which must be restated. The Bureau agrees to improve its oversight of tax increment financing and, where appropriate, to collect the unremitted overcapture or to recommend to the State Tax Commission that it institute proceedings to enforce the provisions of the various tax increment financing statutes.

FOLLOW-UP CONCLUSION

We concluded that the Bureau had partially complied with the recommendation.

Regarding the \$15.8 million due to the State cited in the audit finding, we determined that the Bureau's Local Audit and Finance Division had collected \$8.4 million of this amount. However, the Division had not collected \$5.5 million in deficiencies that were contested by two local units (Auburn Hills and Saginaw). The remaining \$1.9 million of the \$15.8 million consists of \$1.7 million in adjustments to the initial amounts outstanding and \$135,800 that our follow-up did not examine.

* See glossary at end of report for definition.

In addition, the Division began auditing captured property taxes associated with tax increment financing in May 2004. Between May 2004 and April 2007, Bureau records indicate that the Division performed audits of approximately 160 local units that captured property taxes. The Bureau further reported that it had collected \$2.8 million of the \$2.9 million in deficiencies identified by these audits.

The Bureau informed us that it is working on an appeal and collection process to resolve contested audit deficiencies and anticipates implementing the process by September 30, 2007.

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

9. Collection of Specific Taxes

RECOMMENDATION

We recommend that the Department determine whether local units of government that are required to remit specific taxes have remitted their portion of the taxes.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees to develop a program to monitor the collection and timely remittance of specific taxes, within the amounts appropriated by the Legislature for that purpose.

FOLLOW-UP CONCLUSION

We concluded that the Department had not complied with the recommendation but is pursuing what it believes to be corrective action.

At the time of our fieldwork, the Department had not analyzed which local units should be remitting the specific taxes cited in the audit finding to the State and it had not implemented procedures to validate the appropriateness of specific tax amounts that were remitted to the State.

The specific taxes cited in the audit finding are the iron ore tax*, the State housing development tax*, the commercial forest tax*, and the private forest tax*. The

* See glossary at end of report for definition.

following chart shows the amounts recorded within the State's accounting system from these taxes for fiscal years 2003-04 through 2005-06:

Specific Tax Collections

	Fiscal Year			Total
	2003-04	2004-05	2005-06	
Iron ore tax	\$ 672,119	\$ 598,319	\$ 1,176,255	\$ 2,446,693
State housing development tax	8,437,098	6,889,146	9,994,674	25,320,918
Commercial forest tax	2,701,616	3,061,409	2,904,149	8,667,174
Private forest tax	0	0	0	0
Total	<u>\$ 11,810,833</u>	<u>\$ 10,548,874</u>	<u>\$ 14,075,078</u>	<u>\$ 36,434,785</u>

The Bureau informed us that the Department is pursuing what it believes to be corrective action through amendatory legislation that would require the applicable local unit treasurer to submit a signed statement, with each monthly remittance to the State, attesting to the amount of iron ore, State housing development, commercial forest, and private forest tax revenues collected during the preceding month. In addition, the amendatory legislation would add a provision to the General Property Tax Act authorizing the Department to charge interest against local units for untimely remittance of iron ore, State housing development, commercial forest, and private forest tax revenues. The Bureau informed us that it has drafted amendatory language; however, it has not yet been introduced to either chamber of the Legislature.

RECOMMENDATIONS AND RESPONSE AS REPORTED IN FEBRUARY 2004:

10. Collection of Interest on Untimely Remittance of State Taxes

RECOMMENDATIONS

We recommend that the Department enforce the provisions of the General Property Tax Act by requiring local units of government to pay interest when delinquent in making payments to the State.

We also recommend that the Department seek amendatory legislation to allow it to charge interest on local units' remittance of other State revenue collections, such as the trailer coach park tax* (Finding 8) or other specific taxes (Finding 9) that

* See glossary at end of report for definition.

may not be subject to the interest requirements under the General Property Tax Act.

AGENCY PRELIMINARY RESPONSE

The Department agrees that oversight of collection of taxes at the local level was insufficient to detect failures by local treasurers to remit taxes collected. The Department has already determined that it lacks sufficient statutory and procedural remedies against local treasurers to enable the Department to seek full restitution from local treasurers who do not comply with the law. The Department disagrees with the statement that Section 87 of the General Property Tax Act, especially in light of Section 87b of the same Act, gives the State the power to seek restitution from local units of government of lost opportunity costs caused by negligent or intentional behavior of local collecting officials relating to either general ad valorem* property taxes or any other specific taxes collected locally on behalf of the State. The Department will submit recommended legislation to give it these tools.

FOLLOW-UP CONCLUSION

We concluded that the Department had not complied with the recommendations but is pursuing corrective action.

Regarding the first recommendation, the Department disagrees that provisions of the existing General Property Tax Act enable it to assess interest against local units of government that are delinquent in turning over IFT and SET revenues collected on behalf of the State. At the time of our fieldwork, the Department had not collected any interest on the untimely remittance of State property taxes. However, the Bureau has drafted amendatory language to the General Property Tax Act that it believes will give the Department authority to assess interest against local units of government for untimely remittance of IFT and SET. The Bureau informed us that the amendatory language has not yet been introduced to either chamber of the Legislature.

Regarding the second recommendation, the Bureau has also drafted amendatory language to the Real Estate Transfer Tax Act and the Trailer Coach Park Tax Act. The Bureau believes that these amendments, combined with the amendment to the General Property Tax Act, will provide the Department with the necessary authority

* See glossary at end of report for definition.

to assess interest against local units of government for untimely remittance of RETT, trailer coach park tax, the four specific taxes cited in Finding 9, and all other property taxes required to be paid at the same time, in the same installments, and to the same officers as taxes imposed under the General Property Tax Act. The Bureau informed us that the amendatory language has not yet been introduced to either chamber of the Legislature.

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

11. Annual Audits of County Government

RECOMMENDATION

We recommend that the Department provide for an annual audit of each Michigan county as required by law.

AGENCY PRELIMINARY RESPONSE

The Department disagrees with the finding that it did not provide for an annual audit of each Michigan county as required by law because it does provide for that audit within the limits of the amount of money appropriated for that purpose as required by Section 21.45 of the *Michigan Compiled Laws*. Beginning in 1991, the Legislature has appropriated \$60,000 per year for this purpose. The Department has spent that amount for that purpose each year. A financial audit of just one county can cost as much as \$35,000.

FOLLOW-UP CONCLUSION

We concluded that the Department had not complied with the recommendation.

The Department disagrees that it is required to audit each county annually unless adequate funds are specifically appropriated for that purpose. It remains the Department's position that its obligation to conduct county financial audits is limited by the amount of money appropriated by the Legislature directly for that purpose and that the Department has conducted audits to the extent of the amount appropriated each fiscal year. In fiscal year 2005-06, the Legislature eliminated the line-item appropriation to the Department for county audits. The Bureau estimates that it would need 18 additional auditors and that it would cost the State \$2.6 million to audit each county annually.

All Michigan counties, except for approximately five counties audited by the Department each year, contract with private accounting firms for their own annual financial audits. However, the scope of those audits are determined by the county management being audited and do not constitute "the auditing of county accounts by competent state authority" as required by Article IX, Section 21 of the Michigan Constitution.

ADMINISTRATION OF DELINQUENT PROPERTY TAXES AND THE SPECIAL ASSESSMENT DEFERMENT FUND

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

12. Delinquent Property Tax Administration Fund

RECOMMENDATION

We recommend that the Local Property Services Section improve its management and administrative controls over the Delinquent Property Tax Administration Fund.

AGENCY PRELIMINARY RESPONSE

The Department notes that it discovered the deficiencies on its own between this audit period and the prior audit report and has corrected them. The Department informed us that the Delinquent Property Tax Administration Fund is in balance. The entire process related to the Delinquent Property Tax Administration Fund has been replaced by Act 123, P.A. 1999, and has dwindling application until 2006, when it expires altogether.

FOLLOW-UP CONCLUSION

We concluded that the recommendation was no longer applicable.

An amendment (Act 123, P.A. 1999) was made to the General Property Tax Act (Sections 211.1 - 211.157 of the *Michigan Compiled Laws*) in 1999 that significantly revised the State's tax reversion process and essentially eliminated activity within the Delinquent Property Tax Administration Fund as of January 1, 2007. The General Property Tax Act (specifically, Sections 211.59 and 211.78n of the *Michigan Compiled Laws*) was also amended (Act 626, P.A. 2006) authorizing the State Treasurer to transfer the remaining balance in the Delinquent Property Tax Administration Fund to the Land Reutilization Fund created by Act 123,

P.A. 1999. At the time of our fieldwork, the Department had not yet transferred the remaining balance to the Land Reutilization Fund.

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

13. Revenue and Accounts Receivable Reconciliations

RECOMMENDATION

WE AGAIN RECOMMEND THAT THE LOCAL PROPERTY SERVICES SECTION RECONCILE ITS REVENUE AND ACCOUNTS RECEIVABLE RECORDS.

AGENCY PRELIMINARY RESPONSE

During the beginning of the audit period, the Department's Finance and Accounting Division, under guidance of the Department's Internal Audit Division, established the method to reconcile these records and has now concluded that the Bureau's processes meet those requirements. The Department does not agree to expend additional resources to make any additional changes to the accounting for the Delinquent Property Tax Administration Fund, which is being phased out.

FOLLOW-UP CONCLUSION

We concluded that the Bureau had complied with the recommendation.

The receivable component, as well as other components, of the audit finding is no longer applicable under the current tax reversion process. Regarding revenue, the Bureau established a process in October 2006 to reconcile its subsidiary records for delinquent property tax redemptions* with the State's accounting system on a monthly basis. Also, the Bureau reconciled its subsidiary records for delinquent property tax sales from the 2005 foreclosure cycle with the State's accounting system and indicated that it would perform this reconciliation on an annual basis for subsequent foreclosure cycles.

* See glossary at end of report for definition.

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

14. Accounting for Delinquent Property Tax Revenue

RECOMMENDATION

We recommend that the Local Property Services Section improve its accounting for the Delinquent Property Tax Program.

AGENCY PRELIMINARY RESPONSE

The Bureau informed us that it corrected the deficiencies the Department found in accordance with the guidelines set out by the Department's Internal Audit Division. The Bureau also informed us that the Delinquent Property Tax Administration Fund is in balance and will have insufficient activity to warrant further procedural changes. The Department is developing the necessary internal accounting processes relating to the new property tax reversion process now that its provisions have taken effect.

FOLLOW-UP CONCLUSION

We concluded that the Bureau had generally complied with the recommendation.

Delinquent property tax revenue is obtained by the Bureau through either redemption by the property owner or from sale of the property. In addition to the delinquent tax revenue, potential interest revenue and various fee revenues are generated by the redemption and sale processes. An additional category of revenue is derived from the sale process when a property sells for an amount greater than what is needed to cover the delinquent taxes, interest, and fees. This additional revenue is classified as excess sales proceeds.

The Bureau properly recorded the various revenues associated with the redemption process within the State's accounting system. However, in relation to the delinquent property sale process, the Bureau improperly combined the various fee revenues with excess sales proceeds and recorded the total amount as excess sales proceeds. Separate revenue classifications are necessary to effectively account for, identify, specify, and categorize the diverse assortment of sales, fees, and interest revenues received through the delinquent property sale process. In relation to fees, accounting classifications are important to determine whether the fees imposed are adequate to meet the expenditures incurred.

RECOMMENDATIONS AND RESPONSE AS REPORTED IN FEBRUARY 2004:

16. Special Assessment Deferment Fund Accounting

RECOMMENDATIONS

WE AGAIN RECOMMEND THAT THE LOCAL PROPERTY SERVICES SECTION MAINTAIN COMPLETE SUBSIDIARY RECORDS FOR THE SPECIAL ASSESSMENT DEFERMENT FUND.

WE ALSO AGAIN RECOMMEND THAT THE LOCAL PROPERTY SERVICES SECTION PROPERLY RECONCILE THE SPECIAL ASSESSMENT DEFERMENT FUND WITH THE STATE'S ACCOUNTING SYSTEM.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with the finding and stated that it has initiated the recommended changes.

FOLLOW-UP CONCLUSION

We concluded that the Bureau had complied with the recommendations.

The Bureau made the necessary improvements to its subsidiary records and implemented a process that reconciled Special Assessment Deferment Fund activity with the State's accounting system on an annual basis. Also, the Bureau reimplemented its process to verify the current ownership of property associated with a special assessment deferment loan that enables the Bureau to better identify terminated deferments.

REVIEW AND AUDITS OF LOCAL UNITS OF GOVERNMENT

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

20. Oversight of Local Units of Government

RECOMMENDATION

We recommend that the Local Audit and Finance Division improve its oversight of the accounting and auditing of public funds for local units of government.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees that it has not taken steps to identify all active authorities and commissions. The Bureau will undertake a study to determine whether State resources, such as the Secretary of State and Library of Michigan, may assist in the identification of authorities and commissions. The Bureau stated that, although it does follow up on those authorities and commissions that are specifically identified and included as component units within an audit, it intends to strengthen its procedures associated with the verification and identification of any component unit that may not have been included within an audit.

The Bureau informed us that it does pursue the local unit or auditor when comments and recommendations are not submitted if pursuing that information is efficient in light of the nature of the direct disclosure in the audited reports.

The Bureau also informed us that it is studying methods of strengthening its oversight of internal control* and accounting deficiencies, including considering legislatively authorized tools other than or in addition to the procedures for takeover under the Fiscal Responsibility Act.

FOLLOW-UP CONCLUSION

We concluded that the Bureau had partially complied with the recommendation.

The Bureau had implemented procedures to address some of the issues noted in the audit finding. Improved monitoring by the Bureau helped ensure that an increased percentage of local unit audit reports and annual financial reports were submitted in a timely manner. Also, the Bureau committed itself to review each local unit audit report filed under Section 141.427 of the *Michigan Compiled Laws*.

However, the Bureau had not implemented a process to determine whether each local unit of government received an audit as required by law. The Bureau acknowledged that its local unit audit population was not 100% reliable but asserted that identifying all authorities and commissions required to file an audit would not be practical or cost effective because these local units of government are created and dissolved on a regular basis with no statutory requirement that they notify the State upon dissolution. Also, the Bureau indicated that monitoring

* See glossary at end of report for definition.

compliance with the audit requirement is problematic because authorities and commissions may elect to file a stand-alone audit report one year and then choose to be included within the applicable county, city, township, or village's audit report the following year. To help address identification concerns, the Bureau now requests that certified public accountants conducting audits of counties, cities, townships, or villages self-report any authority or commission within the boundaries of the audited entity that is not included in the audit or does not have a stand-alone audit.

In addition, the Bureau had not implemented a process to ensure that it received written communication of internal control deficiencies noted by the local unit's auditors, commonly referred to as a management letter. The Bureau tracks whether such a management letter had not been received but had not implemented a process to ascertain whether the local unit, or its auditor, should have submitted a letter. In addition, the Bureau had not implemented a process to follow up on significant internal control and accounting deficiencies communicated to the Bureau. The Bureau informed us that it intends to establish a process for pursuing delinquent management letters and following up on significant internal control and accounting deficiencies by October 2007.

RECOMMENDATION AND RESPONSE AS REPORTED IN FEBRUARY 2004:

21. Performance Audits of State Transportation Funds

RECOMMENDATION

We recommend that the Local Audit and Finance Division complete more performance audits to establish accountability over payments of State transportation funds to local units of government.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with the facts presented in this finding but disagrees with the implication that the Bureau could have complied in the time frame suggested. The first steps were to develop a performance audit process, a task not usually performed by the Department. In light of recent budget reductions and hiring freezes, the Bureau is now determining which other programs to discontinue to permit it to conduct performance audits.

FOLLOW-UP CONCLUSION

We concluded that the Bureau had complied with the recommendation.

The Bureau conducted four performance audits during fiscal year 2004-05 and another four during fiscal year 2005-06. Also, the Bureau anticipates completing at least four more during summer 2007.

The Bureau hopes to further increase the number of performance audits conducted each year with the addition of two auditors. Interviews for the positions took place in April 2007. However, because of the Statewide hiring freeze mandated by Executive Directive No. 2007-13, the Bureau may not be able to extend an offer of employment. The effective dates of the Executive Directive were March 29, 2007 through September 30, 2007.

GLOSSARY

Glossary of Acronyms and Terms

ad valorem	A method of imposing tax based upon value.
AOR	assessing officer's report.
commercial forest tax	A tax paid in lieu of general property tax on land designated as a commercial forest under the Natural Resources and Environmental Protection Act to the credit of the School Aid Fund.
General Property Tax Act	An act providing for the levy, collection, and administration of ad valorem tax on property.
industrial facility tax (IFT)	A tax paid in lieu of general property tax to a local unit of government by a business that has been granted a tax exemption for restoring, replacing, or constructing an industrial facility. The local unit is required to remit the school districts' portion of the tax to the Department of Treasury to the credit of the School Aid Fund.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
iron ore tax	A tax paid in lieu of general property tax on low grade iron ore mining property to the credit of the School Aid Fund.
material condition	A reportable condition that could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.

performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
private forest tax	A tax paid in lieu of general property tax on land designated as a private forest reservation under the Natural Resources and Environmental Protection Act to the credit of the School Aid Fund.
real estate transfer tax (RETT)	A tax on the value of real property transferred by contract for the sale or exchange of property or by deeds or instruments of conveyance of real property for consideration.
redemption	A process by which the property owner, prior to foreclosure and vesting of absolute title in the State or county, reclaims title by paying delinquent taxes, fees, penalties, and interest due.
reportable condition	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.
reversion	A process by which delinquent property taxes are collected or, in lieu of collection, a process by which an owner of tax delinquent property is divested of title to the property due to nonpayment of taxes.
special assessment	An assessment against real property calculated on a benefit or ad valorem basis for improvements such as curb, gutter, sidewalk, sewer, water, or street paving, whether a repair to an existing system or establishment of such where none exists.

Special Assessment Deferment Fund	The fund established to assist an owner of a homestead who is 65 years or older or who is totally and permanently disabled through long-term low interest loans.
State education tax (SET)	An ad valorem tax levied upon real and personal property under the General Property Tax Act, the proceeds of which are required to be deposited to the credit of the School Aid Fund.
State housing development tax	A tax paid in lieu of general property tax on housing projects under the State Housing Development Authority Act to the credit of the School Aid Fund.
tax increment financing	A system of financing public improvements in designated areas by obtaining property tax revenue from incremental increases in property values within the designated area.
trailer coach park tax	A monthly tax on trailer coaches located in licensed trailer coach parks, paid in lieu of general ad valorem property tax to the credit of municipalities, counties, and the School Aid Fund.

